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September 9, 2002

Marlene H. Dortch, Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

Re: Applications of Qwest Communications International Inc.
WC Docket Nos. 01-148, 02-189
Ex Parte Filing

Dear Ms. Dortch:

This responds to the *ex parte* letter filed on Friday, September 6, 2002, by AT&T Corp. ("AT&T") in the above-referenced docket, in response to the comments filed by Qwest Communications International Inc. ("Qwest" or "QCII") on September 4, 2002. For the reasons set forth below, Qwest clearly complies with section 272, and AT&T's legal arguments are fatally flawed on multiple levels.

AT&T's rhetoric essentially boils down to this: even assuming that Qwest has otherwise met the requirements of section 271, it should not be allowed to compete in the long distance market until it completes restatement of financial accounts for prior period transactions having nothing to do with the purposes of section 272. According to AT&T, this would be true even though (1) Qwest has fully opened its local exchange markets in accordance with the requirements of section 251; (2) the public interest would be served by grant of this application; and (3) Qwest has demonstrated that it will operate its interexchange business separately from the BOC in all respects.

Of course, AT&T predictably does not concede any of these points; it is engaged in a last ditch effort to block competition to itself. But for present purposes AT&T's argument is a legal one aimed at the scope of the Commission's discretion under the Act. AT&T is contending that, even if a BOC has met all other requirements of section 271, the FCC must read section 272(b)(2) so broadly as to deny the application of an otherwise eligible BOC for this technical legal issue. AT&T takes this position in the face of evidence that Qwest Corporation ("QC," the BOC) and Qwest Communications Corporation ("QCC," the 272 affiliate), are and have been correctly accounting for the transactions between them -- the fundamental matter that section 272(b), (c) and (d) address in the accounting sphere.

It would be a peculiar result -- and one very detrimental to the public interest and competition -- if, after all the work of Qwest, state regulators, this Commission and other parties to open Qwest's local markets, these section 271 applications were to fall based on AT&T's self-serving reading of section 271. And in fact, the Telecommunications Act itself does not require this peculiar result. As discussed below, AT&T is misinterpreting the Act and the Commission's rules. That authority does not require the Commission to deny this application while accounting adjustments are made for unrelated past transactions. Rather, the Act and the Commission's rules accommodate, indeed are fully consistent with, a common sense approach recognizing that such adjustments are not material to the question of how QCC will operate in the future. Qwest has made the necessary showing to permit the Commission to find that it will maintain the relevant books, records, and accounts of QCC in accordance with GAAP. AT&T's expansive reading of section 272 should be rejected.

1. AT&T first expends considerable energy on the irrelevant proposition that an agency cannot repeal or modify "a legislative rule" without notice and comment. This argument is premised on a misreading of the language used by Congress in section 272(b)(2), and a mischaracterization of paragraph 170 of the *Accounting Safeguards Order.* As shown below, the Commission has considerable discretion in interpreting its own prior decisions in accordance with the policies of the statute.

a. Contrary to AT&T's paraphrase of the statute, section 272(b) does not direct 272 affiliates to maintain their books, records, and accounts "in accordance with uniform accounting standards." AT&T Letter at 2. *See also id.* at 3 (urging Commission to apply section 272(b)(2) "as written"). It directs them to maintain such books, records, and accounts "in the manner prescribed by the Commission." 47 U.S.C. § 272(b). Thus, Congress left this matter squarely within the Commission's discretion. *That* is the significant difference between the language of section 272(b)(2) and the language of section 272(c)(2).

b. AT&T also claims that "the plain and unambiguous language" of the Commission's current "rule" extends the prescription of generally accepted accounting principles ("GAAP") beyond the BOC-272 affiliate relationship that lies at the core of section 272. There is no such "rule," and AT&T cites none. What it relies upon is the language of paragraph 170 of the Commission's *Accounting Safeguards Order*, requiring section 272 affiliates to maintain their books, records, and accounts "in accordance with GAAP."[1] This language does clearly prescribe what *accounting principles* shall govern here (*i.e.*, GAAP vs. Part 32 rules). It does not, however, address what *transactions* (or even what documents) shall be governed by those accounting principles. This is a question of first impression, as to which the Commission has never provided any specific guidance.

c. In interpreting the scope of its own GAAP requirement established in the *Accounting Safeguards Order*, the Commission has even greater discretion than it would in interpreting the statute itself. As the D.C. Circuit has repeatedly recognized, "[I]t is well established that an

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[1] Report and Order, *Implementation of the Telecommunications Act of 1996: Accounting Safeguards Under the Telecommunications Act of 1996*, 11 FCC Rcd. 17539, 17618 ¶ 170 (1996) ("*Accounting Safeguards Order*").

agency's interpretation of the intended effect of its own orders is controlling unless *clearly erroneous*."[2] And it is, of course, equally well established that agencies also have substantial discretion to resolve such issues in the course of adjudicatory proceedings.[3] Contrary to AT&T's suggestion, that is even more true in section 271 proceedings, in which the statutory deadline for Commission action would make rulemaking proceedings wholly impracticable. The Commission's 271 orders are filled with guidance about the scope of 271 and 272 requirements, upon which the parties can and do consistently rely.

SBC Kansas-Oklahoma is not to the contrary. It simply notes that such "highly specialized, 90-day proceedings" could not function as intended "if we were generally *required* to resolve" all interpretive disputes about the scope of the local competition provisions of sections 251 and 252 in the course of such proceedings.[4] Those provisions, of course, are not at issue here. And the Commission has always been quite careful to preserve its broad *discretion* to address (or not to address) any previously unresolved legal issues relevant to the section 271 determination.[5] Finally, the Commission has commonly exercised that discretion to construe ambiguous legal requirements so as to promote the benefits of interLATA competition, without thereby prejudicing its options for ultimately resolving the issue in subsequent proceedings.[6]

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[2] *MCI Worldcom Network Services, Inc. v. FCC*, 274 F.3d 542, 547 (D.C. Cir. 2001) (quotations and citation omitted) (emphasis added). *See Cassell v. FCC,* 154 F.3d 478, 483-84 (D.C. Cir. 1998); *Global Crossing Telecommunications, Inc. v. FCC*, 259 F.3d 740, 746 (D.C. Cir. 2001); *United States Telecom Assoc. v. FCC,* 295 F.3d 1326, 1332 (D.C. Cir. 2002). *See generally Thomas Jefferson Univ. v. Shalala,* 512 U.S. 504, 512 (1994); *Robertson v. Methow Valley Citizens Council*, 490 U.S. 332, 359 (1989); *Udall v. Tallman*, 380 U.S. 1, 16 (1965); *Bowles v. Seminole Rock & Sand Co.,* 325 U.S. 410, 413-14 (1945).

[3] *NLRB v. Bell Aerospace Co.*, 416 U.S. 267, 294 (1974); *accord, e.g., Petition for Declaratory Ruling by AirTouch Communications, Inc.*, 15 FCC Rcd 13826, 13827-29 ¶¶ 6-10 (WTB 2000).

[4] *Joint Application by SBC Communications Inc., Southwestern Bell Tel. Co., and Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long Distance for Provision of In-Region, InterLATA Services in Kansas and Oklahoma*, 16 FCC Rcd 6237, 6246 ¶ 19 (2001) (subsequent history omitted) (emphasis added).

[5] *See id.;* Memorandum Opinion and Order, *Application by SBC Communications Inc., Southwestern Bell Tel. Co., and Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long Distance Pursuant to Section 271 of the Telecommunications Act of 1996 To Provide In-region, InterLATA Services in Texas*, 15 FCC Rcd 18354, 18366-68 ¶¶ 23-28 (2000) ("*SBC Texas Order*").

[6] Memorandum Opinion and Order, *Joint Application by SBC Communications Inc., Southwestern Bell Tel. Co., and Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long Distance Pursuant to Section 271 of the Telecommunications Act of 1996 To Provide In-Region, InterLATA Services in Arkansas and Missouri*, 16 FCC Rcd 20719, 20759-60 ¶ 82 (2001) ("*Arkansas-Missouri Order*") (assuming, for purposes of section 271

2. As Qwest has demonstrated in its recent comments, section 272(c)(2) clearly reflects a legislative policy judgment to confine the section 272 review of the BOC's accounting practices to transactions with its section 272 affiliate, and in determining "the manner" in which the section 272 affiliate should maintain its books, records, and accounts, the Commission addressed the two obligations in tandem. Applying the same principle to the section 272 affiliate comports with the recommendation of symmetry that the Commission adopted from the comments in order to maintain a "uniform audit trail" for transactions between the BOC and its 272 affiliate. And it is consistent with the twin goals of policing against discrimination and cross-subsidization by the BOC in favor of the 272 affiliate, which the Commission has consistently recognized are those underlying section 272.[7]

This policy is also reflected in section 272(d). That provision requires "[a] company" with a separate affiliate (*i.e.*, a BOC) to undergo biennial audits of its compliance with the requirements of section 272. 47 U.S.C. § 272(d)(1). To permit such audits, it ensures access to "the financial accounts and records" of each such company and its affiliates that are relevant to the activities permitted for a section 272 affiliate and "necessary to verify transactions conducted *with that company*" [*i.e.*, with the BOC]. *Id.* § 272(d)(3)(A) (emphasis added).

3. Without addressing any of these issues, AT&T advances two reasons for its contrary view, under which it simply urges the Commission to "do its part"[8] in duplicating the SEC's functions with respect to transactions between the 272 affiliate and unaffiliated third parties. Neither has any basis in law or in logic.

a. First, AT&T argues that looking at the terms on which the 272 affiliate transacts business with such third parties can provide an "apples-to-apples" comparison that is necessary because regulators and competitors would otherwise have "little ability to detect" sales of services by the affiliate to the BOC at artificially inflated prices.[9] But this ignores the

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process, that BOC has no obligation under section 251(c)(4) to offer DSL information services for resale at wholesale rates).

[7] *See, e.g., Arkansas-Missouri Order* at 20780 ¶ 122.

[8] AT&T Supplemental Comments (Sept. 4, 2002) at 9. *See also id.* at 4 ("other government bodies are working so diligently to combat accounting misconduct . . . through strict enforcement of accounting requirements").

[9] AT&T Letter at 3. AT&T's argument seems confused: it variously speaks of "inflated prices" charged by QCC to the BOC, and "discriminatory sales of services" by QCC to the BOC, *i.e.*,at lower than market prices. AT&T Letter at 3. The latter concern is outside the scope of section 272. Because QCC operates in a competitive market, it is not subject to any nondiscrimination requirements such as those governing the BOC in section 272(c). In any event, in policing the BOC's nondiscrimination obligations, Congress found no need to refer to the BOC's transactions with unaffiliated third parties, as it logically would have done if it shared AT&T's position about "apples-to-apples" comparison involving BOC *affiliates* and third parties. 47 U.S.C. § 272(c)(2).

Commission's adoption of a series of stringent controls, in implementing the "arm's length" requirements of section 272(b)(5), that are expressly designed to address this risk. These include a description of such transactions to be promptly posted to a web site, providing competitors with detailed information about the prices and other terms and conditions of the transaction. *Accounting Safeguards Order* at 17593-94 ¶ 122. The Commission also imposes upon such transactions the valuation requirements of its existing affiliate pricing rules, which "already ensure that affiliate transactions are conducted at compensatory prices." *Id. at* 17593 ¶ 121. *See also id.* at 17607 ¶ 147 (modifying current rules regarding valuation of affiliate services, thereby "guarding against cross-subsidization of competitive services by subscribers to regulated telecommunication services").

Moreover, there is nothing "apples-to-apples" here at all. AT&T seeks to justify a review of *all* the 272 affiliate's transactions with unaffiliated third parties because of the mere possibility that some similar transaction might theoretically be made with the BOC. The only example it offers underscores how speculative this possibility really is. AT&T cites to (and has attached to its September 4 comments) the posting by QCC of task orders describing its lease of dark fiber and transport capacity to QC. As that posting itself makes clear, these leases are not IRUs, have materially different terms and conditions, and thus could not fairly be compared to the IRU agreements with unaffiliated third parties that AT&T has repeatedly sought (through one guise or another) to import into this proceeding.[10] Equally important, the third party transactions entered into by QCC are competitive market transactions; thus, the marketplace already provides its competitors with abundant alternative benchmarks (including their own transactions) to which they may compare the posted terms of QCC-QC transactions.

b. AT&T also claims that the Commission needs to know how well QCC is doing financially, in order to determine whether QC's access charges (to QCC and other IXCs) are too high. The short answer to this access charge price squeeze argument is that it has nothing to do with the purposes of section 271 or 272.[11] As Qwest has already demonstrated, both Congress and the Commission have concluded that the section 271 approval process and access charge reform are not, and should not be, linked.[12] The question of whether QC's access charges are too

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[10] Such leases are month-to-month or short term transactions, and are subject to termination on 60 days notice. *See* Declaration of Judith L. Brunsting, Ex. JLB-272-13, Services Agreement Between QC and QCC, Article 2. In contrast, IRUs are typically twenty-year term agreements. As the website description notes, such leases "d[o] not provide QC with any ownership interest in or other rights to physical access, control of, modification of, encumbrance in any manner or other use of the QCC Network."

[11] AT&T Letter at 3. *See also* AT&T Supplemental Comments at 14.

[12] Brief of Qwest Communications International Inc. in Support of Consolidated Application for Authority to Provide In-Region, InterLATA Services in Montana, Utah, Washington, and Wyoming at 191-92 (July 12, 2002). As noted therein, the Commission has made clear that access charge reform is not a prerequisite to section 271 approval, and indeed that "Congress anticipated that some [BOCs] would obtain authorization under 47 U.S.C. 271 to originate in-region long-distance services before the completion of access charge reform."

high is one that can be (and is being) addressed by this Commission and state commissions in proceedings that are designed to answer that question based on an analysis of the actual costs of providing exchange access services -- not by reference to whether affiliated (or unaffiliated) IXCs are making a profit for reasons that may be wholly unrelated to the charges they pay for such services.

4. AT&T next repeats its claim that QCC cannot currently maintain its books, records, and accounts in accordance with GAAP if its parent company has been unable to certify its financial statements. This argument has three premises, none of which is correct.

a. AT&T makes no effort to address the numerous provisions of the Telecommunications Act of 1996 ("The Act"), the Communications Act of 1934, and other statutes, and the accounting treatises, cited by Qwest that support the clear distinction between "books, records, and accounts" maintained by the company, and financial statements it prepares and files with the SEC.[13] The biennial audit provisions of section 272 itself confirm this distinction, by establishing a right of access to "financial accounts and records" in order to conduct the biennial audit. 47 U.S.C. § 272(d)(3)(A). Congress itself thereby indicated which documents (and, as noted above, which transactions) are in fact essential to the section 272 "audit trail." The cases cited in AT&T's own supplemental comments also demonstrate that the books, records, and accounts are the pertinent documents, because they are the source materials used to prepare (and audit) the financial statements.[14]

This is the same distinction established in *SEC v. World-Wide Coin Investments, Ltd.,* 567 F. Supp. 724 (N.D. Ga. 1983), which the SEC staff has identified as the "only . . . judicial decision that discusses [the relevant provision of the securities laws] in any detail." 1999 WL 1123073 (SEC Release No. 99), at n.34 (Aug. 12, 1999). As noted in that decision, the maintenance of financial records involves "major every-day activities" of the reporting company. Such "source documents" are designed in turn to "permit the preparation of financial statements in conformity with GAAP and other criteria applicable to such statements," and it is the source documents, not financial statements, that provide for maintenance of an "audit trail." 567 F. Supp. at 747, 748, 752.

Supplemental Order Clarification, *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996,* 15 FCC Rcd 9587, 9597-98 ¶¶ 19-20 (2000).

[13] *See, e.g.,* 47 U.S.C. § 274(b)(1) (electronic publishing affiliates required to "maintain separate books, records, and accounts *and prepare separate financial statements"*) (emphasis added); *id.* § 396(*l*)(3)(B) (CPB-funded entities required to "keep . . . books, records, and accounts in such form as may be required by the Corporation" and subject them to periodic audit, or may *alternatively* "submit a financial statement in lieu of the audit").

[14] *See United States v. Arthur Young & Co.,* 465 U.S. 805, 811 (1984) (noting that under SEC rules an independent auditor must determine accuracy of financial reports by examining "books and records"); *Conley v. United Steelworkers of Am.*, 549 F.2d 1122, 1123-24 (7th Cir. 1977) (LMRDA allows union members access to "books, records, and accounts, " in order to acquire "full information related to the financial affairs of [their] unions")

The single case cited by AT&T on this issue is one in which the court dismissed, for lack of proper venue, claims of "keeping false books and records" in the form of financial statements, because the only place the court concluded that the books and records of the corporation (as opposed to financial statements filed with the SEC) could be "made" or "kept" for venue purposes was in the corporate offices in Montana. *United States v. Crop Growers Corp.*, 954 F. Supp. 335, 351-54 (D.D.C. 1997). This distinction supports, rather than undermines, Qwest's position. Although the court later stated that "financial statements and records are not sufficiently distinct to warrant differential treatment," it did so only in the context of a motion to strike references to financial statements from the indictment, in light of the principle that "motions to strike are rarely granted" and only for language that is "irrelevant and prejudicial." *Id.* at 356-57. This procedural holding cannot begin to undermine the substantive principle acknowledged in *World-Wide Coin*, much less the clear distinction between books, records, and accounts and financial statements set forth by Congress in the Act and the numerous other federal statutes cited by Qwest in its September 4 comments.

b. AT&T next argues that because QCC is *"failing to make"* revenue entries relating to past contracts in which revenue was recognized "up-front rather than over the life of the contract," it cannot currently be maintaining its books, records, and accounts appropriately under GAAP. AT&T Letter at 4, 5 (emphasis in original). As Qwest has noted in its comments, however, and as set forth in the verified letter of Chief Financial Office of August 26, 2002, QCC is making all individual transaction entries for new matters appropriately. It is also "implement[ing] internal control mechanisms reasonably designed to prevent, as well as detect and correct, any noncompliance."[15] It is therefore currently maintaining its books, records, and accounts appropriately. The absence of entries relating to prior transactions does not undermine this showing that all entries for transactions taking place after 271 approval will be correct, and does not deprive the Commission of the "audit trail" it needs to verify how QCC will account for such transactions, or to make the predictive judgment that the 271 authorization "will be carried out" in accordance with the requirements of section 272. 47 U.S.C. § 271(d)(3)(B).

c. AT&T argues that QCC has not supported its assertion that it is accounting for all new transactions in accordance with GAAP. But that is precisely what the company's new Chief Financial Officer did in his verified letter described above. And in its recent comments, Qwest has further demonstrated the underlying foundation for that statement. This includes a review of regular reports from KPMG and QCII's Senior Vice President - Accounting and Financial Operations ("SVP"), a two-month process of reconciliation involving approximately 4500 individual accounts in the general ledgers, the reorganization and expansion of technical accounting functions and capabilities so as to report through the SVP rather than the business units, and the creation of a new Project and Analysis Group responsible for establishing and managing the accuracy of QCC's books, records, and accounts.[16]

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15 *SBC Texas Order* at 18549-50 ¶¶ 398.

16 Comments of Qwest Communications International Inc. at 15-17 (Sept. 4, 2002).

5. Finally, AT&T argues that the KPMG Report attached to its recent comments with respect to QC-QCC transactions simply "took as given Qwest management's assertions." AT&T Letter at 6. That is incorrect. Before making its report, KPMG itself reviewed management's assertions about *all* of the 42 potential restatement items identified by QCII as of August 26, 2002. Based on that independent review, KPMG has found no reason to disagree with the assertion that only one of them is a direct QC-QCC transaction.[17] Its review was conducted "in accordance with attestation standards established by the American Institute of Certified Public Accountants." These standards require a reasonable basis for the conclusions stated in the report, based *inter alia* on the knowledge obtained during current and previous engagements.[18] In the course of its review, KPMG discussed each potential restatement item with management, as well as those employees directly involved in processing and investigating the transactions. KPMG also tested support documentation as it determined appropriate. And as noted in QCII's SEC Form 8-K filed July 29, 2002, its continuing review of its accounting policies and procedures has been conducted generally in consultation with KPMG.

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Over the past three years in these proceedings, Qwest has made a compelling showing that it has opened its local markets to competition, through both its wholesale performance (and assurance of future performance) and its pricing of wholesale services. It has also established a section 272 affiliate and demonstrated that the proven competitive benefits of interLATA entry supported by each of the relevant state commissions "will be carried out" consistently with section 272. The Commission can make that predictive judgment based upon unprecedented reviews by KPMG, and clear and unequivocal commitments from Qwest's new management that QCC is maintaining its books, records and accounts going forward in accordance with GAAP, both for transactions with QC that lie at the core of section 272 and for transactions with third parties. The availability of the biennial audit process will ensure that these commitments are taken seriously.

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[17] As Qwest has noted in its comments (at 19), this potential restatement item involves an adjustment previously filed in an April 2002 ARMIS report, which was booked by that time to the general ledger, and thus has already long been reflected on QCC's books, records, and accounts.

[18] AICPA Professional Standards, Section AT-101.51, 101.57.

The Commission should thus reject AT&T's efforts to expand section 272 far beyond its intended purposes to bar competitive entry based upon accounting questions that implicate neither discrimination nor cross-subsidization concerns. The Commission has the clear discretion, and indeed an obligation, to interpret both sections 271 and 272 and its prior decisions in a manner that fulfills their purposes, including that of promoting interLATA competition. As the D.C. Circuit has held, failing to do so would "deprive the ultimate beneficiaries of the 1996 Act -- American consumers -- of a valuable source of price-reducing competition in the long distance market."[19]

Respectfully submitted,

William T. Lake
William R. Richardson, Jr.
Jonathan E. Nuechterlein
Jonathan J. Frankel

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19 *AT&T Corp. v. FCC*, 220 F.3d 607, 632-33 (D.C. Cir. 2000).